The Visionary 2008–09 Budget

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1. Introduction

In 2007–08, Hong Kong's fiscal surplus reached an "all-time high", estimated by the 2008–09 Budget at $115.6 billion, which was $90.2 billion more than the amount forecast by the previous budget. This unprecedented windfall substantially relaxed the financial constraints for Financial Secretary John C Tsang when he formulated the 2008–09 Budget.[1] As a result, he had plenty of room to raise expenditures and cut taxes in this, his first budget. Indeed, his proposals have turned the all-time high surplus into a deficit forecast to be $7.5 billion in 2008–09.

The 2008–09 Budget appears to be an ambitious budget. Its Supplement uses six pages to list a total of 69 "major" proposals,[2] 21 of which in particular are expected to cost the government $1 billion or more apiece. The most "expensive" one is a visionary proposal earmarking $50 billion as start-up capital to be used for introducing supplementary financing arrangements in healthcare reform, which have yet to be finalised by an extended consultation on the subject. In other words, there will be a start-up capital of $50 billion for supplementary healthcare financing, irrespective of the final form of the arrangements. It is an unconditional commitment!

A related proposal in the 2008–09 Budget provides a one-off injection of $8.5 billion to Mandatory Provident Fund (MPF) accounts.[3] These two proposals will help Hong Kong society better prepare for the mounting population-ageing problem. Note that more than half the 2007–08 surplus has been allocated to these accounts. It shows, on the one hand, that the government is committed to tackling the population-ageing problem, while on the other, it underscores the severity of the problem and the fact that a lot more needs to be done. Some of these issues and suggested solutions are discussed next.

2. Ageing Population

2.1. MPF

More than a year ago I proposed the idea of a one-off injection to MPF accounts (Ching 2007). At that time, I toyed with the idea that one-off measures do not have to be short-term, and I tried coming up with a long-term solution to the population-ageing problem based on such measures. These measures are preferable for the following reason. Fiscal surpluses/deficits vary to a large extent with economic performance. If the government cuts taxes during good times, it will find it politically costly to raise taxes when it faces fiscal deficits during bad times.[4] Therefore, I suggested structuring the salaries tax rebate as a one-off injection to MPF accounts.[5]

The idea gained momentum between late 2007 and early 2008 when more and more people used it in their budgetary submissions, all of which interestingly appeared to be independent. In any case, it is effective for getting a message across when it is repeated several times in slightly different ways. The government eventually adopted the idea in the 2008–09 Budget and proposed making a one-off injection of $6,000 to the MPF accounts of those who made $10,000 or less a month. Did the number $10,000 have any magic? Why was there no MPF injection for those making more than $10,000 a month? Did the government believe these people could support their retirement on their own? Was it contradictory to its own claim that population ageing is one of Hong Kong's biggest challenges? Indeed, the government would have been wiser not to have any such magic number. It could then have delivered a more coherent message on the severity of the population-ageing problem by structuring all salaries tax rebates as a one-off injection to MPF accounts.

While making a one-off injection to MPF accounts is a new idea, regular savings by people for their own retirement is more important and should be encouraged by the government. At a minimum, the government should provide proper tax incentives. One would be surprised by the paucity of the incentives the existing tax provisions offer. Currently, an employee's MPF contribution for tax deduction purposes is capped at $12,000 a year, or more precisely, $1,000 a month. On the one hand, the government claims that the money in the existing MPF system is far from sufficient to meet the needs of the ageing population (otherwise healthcare financing reform would not be necessary). But on the other, the government caps the tax-deductible amount of an employee's MPF contribution at $1,000 a month. If the money in the MPF system is insufficient, shouldn't the government lift the cap to encourage more savings going into the system? It is time for the government to show more commitment by putting its money where its mouth is.

It is important to recognise that more MPF contributions alone cannot sufficiently fund the system. First, there is a limit on savings, especially for the low-income group already struggling with meagre incomes. Second, more savings does not help much if MPF providers fail to deliver a reasonable investment performance. There is clear evidence showing that MPF providers underperform the market, for example, the Hang Seng Index. Indeed, it is a well-established research result that the most actively managed funds underperform the market, the key reason being high management fees. The same applies to MPF providers in Hong Kong. A simple solution to boost MPF investment performance would be to require all MPF providers to give their account holders the option to invest in index funds,[6] which have minimal management fees. This would be a practical solution in Hong Kong, because there are already plenty of index funds, known as Exchange Trade Funds (ETFs), covering various markets and sectors and traded on the Hong Kong Exchanges. Both the variety and popularity of ETFs are growing fast in Hong Kong.

2.2. Healthcare Financing

Chapter 1 of *Your Health Your Life – Healthcare Reform Consultation Document* articulated the following point well. The existing healthcare system is not sustainable as a consequence of population ageing. Reforming the system is imperative. The document proposes six supplementary financing options. I offer a brief review of the six options here, organising my analysis by their two underlying components: medical savings and insurance.

The consultation document considers Medical Savings Accounts as Option 3 (Chapter 10), which is also a key component of Option 6, called Personal Healthcare Reserve (Chapter 13). Meeting medical expenses is probably the most significant function of retirement protection. Hence, it would be more holistic to address the question by ensuring sufficient funding for retirement protection, as suggested in Section 2.1, instead of introducing Medical Savings Accounts as a Band-Aid solution. Another drawback of establishing Medical Savings Accounts is the addition of a redundant administrative structure on top of the existing MPF system.

A limitation of using the MPF system for healthcare financing is that it does not offer risk pooling. Risk pooling is important because illness can be catastrophic and personal wealth can easily be exhausted by the associated expenses. Hence, insurance is an indispensable component for healthcare financing. Note that Social Health Insurance (Option 1) essentially stretches the existing public healthcare system with a new hypothecated employment-based or income-linked tax. It is not an ultimate answer to providing sustainable financing for an ageing population.

Voluntary Private Health Insurance (Option 4) is plagued by the problem of "adverse selection". To the extent that an insurance company cannot distinguish the healthy from the unhealthy, a single premium has to be charged to both groups. This premium needs to be steep enough to protect the insurance company from losing money to cover the unhealthy, but this makes it too steep for the healthy to buy from the insurance company. The outcome is undesirable, because the healthy are not protected and the unhealthy are being charged a steep premium. This is a classic example of market failure in economics.

Adverse selection could be avoided by mandatory private insurance, but this is subject to another well-known problem called "moral hazard", meaning that the insured are more likely to abuse the system. Fortunately, moral hazard can be contained by imposing co-payments and deductibles. Hence, Mandatory Private Health Insurance (Option 5) is the preferred choice. (Option 2 is Out-of-Pocket Payments, an undesirable option because it involves neither savings nor insurance.)

2.3. Retirement Age

It is simple arithmetic that one more year of work means one more year of income to support one less year of retirement. Alas, this simple remark is relevant to Hong Kong, because a retirement age is still practiced here. The government should outlaw a retirement age not to increase the money in the MPF system, but for a much stronger reason. A retirement age is a manifestation of age discrimination. Outlawing it shows the government's commitment to ending age discrimination in Hong Kong. It should be emphasised that an employer's right to terminate employees would not be affected by abolishing a retirement age. It only means there would be no forced retirement when employees reached an arbitrary "retirement age". The "retirement age" is arbitrary; for instance, it has not been adjusted in accordance with the increasing life expectancy in Hong Kong. A longer life expectancy indicates that people remain healthy, and hence productive, for a longer period in their life. In any case, retirement ages should vary across individuals, instead of being fixed at a certain age for everyone.

3. Foreign Domestic Helper Levy

It is fair to say that while the 2008–09 Budget contains many new initiatives, none are targeted to benefit the middle class. In October 2003, the government started imposing a foreign domestic helper levy of $9,600 per standard contract. The levy was imposed based solely on budgetary considerations (the $70 billion deficit in 2002–03), but the money collected was channelled to the Employees Retraining Board. The strong economic recovery of the past few years has led this artificial structure to accumulate a surplus. More importantly, the budgetary reason for collecting the levy no longer exists. To show real commitment to all people in Hong Kong society, the government should abolish the foreign domestic helper levy.

4. CSSA and Old Age Allowance

It is unfortunate that the new Financial Secretary maintains the position of sharing the fruits of economic prosperity with Comprehensive Social Security Assistance (CSSA) recipients by giving them one additional month of payment. This bad practice has been adopted the second time in a row, making it harder to change in the future. However, I am *not* opposed to give an additional month of CSSA payments this year. What the new Financial Secretary should have said is that this additional month of payment is a special measure to cope with surging inflation, which cannot be adequately addressed by existing mechanisms. Indeed, it is important that the government adjust CSSA payments in line with inflation, especially when the prices of necessities, such as food, are increasing so quickly.

On the other hand, the new Financial Secretary is to be commended for granting a one-off additional Old Age Allowance of $3,000 instead of raising it on a monthly basis. The Old Age Allowance is not means-tested and should not be increased. In fact, it should not have been introduced in the first place. This is a good example showing that political expediency should be resisted so that undue entitlements do not result. John C Tsang is more principled than his predecessors.

5. Summary

The 2008–09 Budget is visionary in setting aside more than half the 2007–08 surplus to tackle the population-ageing problem in Hong Kong, which is the focus of this article. The following measures are suggested:

- All salaries tax rebates should be structured as one-off injections to MPF accounts, irrespective of the amount of income earned each month.
- All employees' MPF contributions should be tax deductible, that is, the existing maximum tax deduction of $1,000 a month should be removed.
- All MPF providers should give their account holders the option to invest in index funds.

Savings are necessary but not sufficient to meet medical expenses, especially for an ageing population. Supplementary financing arrangements need to be introduced, and Mandatory Private Health Insurance (Option 5) is the preferred choice for going forward.

This Budget is not entirely fair and does not pay sufficient attention to the middle class. It is suggested here that the foreign domestic helper levy be rescinded. Unfortunately the new Financial Secretary has failed to take the opportunity of surging inflation to rectify the bad practice of sharing the fruits of economic prosperity with CSSA recipients. However, he is to be commended for resisting increasing the non-means-tested Old Age Allowance on a monthly basis.

References

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Endnotes

1. Article 107 of the Basic Law stipulates that "the Hong Kong Special Administrative Region shall follow the principle of keeping the expenditure with the limits of revenues in drawing up its budget, and strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its gross domestic product".

2. The meaning of "major" can be better understood only by going through the list in the Supplement. For instance, it lists "to vigorously implement various infrastructure projects over the next few years, including the ten major projects announced by the Chief Executive" as the first major proposal. If this is a major proposal, one cannot but wonder how many major infrastructure projects, including those announced by the Chief Executive, have not been (vigorously) implemented. A natural, and fair, question to ask is how many of the infrastructure projects referred to in the Supplement will actually be implemented in the next "few" years.

3. The 2008–09 Budget Concluding Speech announced that the total amount of injection will be increased to $11.5 billion and the number of beneficiaries from some 1.3 million to some 1.7 million, as a result of broadening the coverage of the measure.

4. The HKSAR government is bound by the Basic Law to maintain a fiscal balance (see supra, note 1).

5. I have long supported using one-off measures to distribute fiscal surpluses back to society (Ching 2001).

6. On top of the index-fund option, MPF providers are free to offer their own actively managed funds to their clients. T